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BEFORE THE
COMMITTEE ON GOVERNMENT REFORM
UNITED STATES HOUSE OF REPRESENTATIVES

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Good morning, Mr. Chairman, and Members of this Committee. I am John D. Graham, Ph.D., Administrator, Office of Information and Regulatory Affairs (OIRA), Office of Management and Budget. Thank you providing me with this opportunity to share our views on H.R. 2432, the "Paperwork and Regulatory Improvements Act of 2003." This bill has stimulated a significant amount of thought and discussion within OIRA about interests we obviously share with this Committee. We endorse the bill's underlying goal of reducing the burdens that the Federal government imposes on the regulated public. While we have a number of concerns with the bill that prevent us from supporting it in its current form, I am hopeful that together we can use it as a starting point for improving regulatory policy.

While I would like to devote the bulk of my remarks to the bill's provisions on regulatory accounting and OIRA staffing, I would first like to address briefly the other two major provisions. Section 4 would repeal the exemptions contained in the Farm Security and Rural Investment Act of 2002 from various paperwork review and regulatory due process requirements. OIRA strongly supports this provision. We would simply recommend that the Section 4 make this repeal effective six months after enactment, so that the Department of Agriculture has sufficient time to comply with paperwork and regulatory requirements. Section 5 would make permanent the authorization for the General Accounting Office (GAO) to respond to congressional requests for independent evaluations of selective economically significant rules proposed or issued by Federal agencies. Since this provision concerns internal Legislative Branch operations, OIRA chooses not to take a position. We would urge the Committee, however, to consider whether GAO or the Congressional Budget Office is the most appropriate entity to be given this responsibility.

Improving Regulatory Accounting

Section 6 of HR 2432 has four provisions aimed at improving OMB's annual regulatory accounting statement. Although we support improvements in regulatory accounting, we have concerns about these four provisions as well as some suggestions.

1. Should All Federal Rules and Paperwork Requirements Be Analyzed?

The provision in Section 6(a) would require that OMB require each agency to submit to OMB an estimate of the “total annual costs and benefits of Federal rules and paperwork...for the agency in the aggregate; and...for each agency program.” This requirement is apparently based on Finding (7) that OMB “does not require agencies to submit estimates on costs and benefits of agency rules and paperwork” which OMB “needs ... to help prepare the annual accounting statement” under section 624 of the Treasury and General Government Appropriations Act, 2001, also known as the Regulatory Right to Know Act. This finding is not entirely accurate. Beginning in 1981, Executive Order 12291 and in 1993 E.O. 12866 have required agencies to submit to OMB estimates of the costs and benefits of their major regulatory actions, defined generally as rules with impacts on the economy of \$100 million or more. OMB has used these data to prepare its annual accounting of the costs and benefits of Federal regulations since 1997.

If Section 6(a) is intended to require an estimation of the costs and benefits of all existing rules and paperwork requirements, this provision is not workable. It would require OMB and agencies to estimate *every year* the costs and benefits of *all* Federal rules, including those adopted 10, 40 and 100 years ago that are still in effect today. (From 1980 and 2003 alone, over 113,000 final regulations were issued by Federal agencies.) Although it is feasible for OMB and agencies to assemble cost and benefit information for major rules adopted over the last ten years, it is not feasible to estimate reliably the costs and benefits of non-major rules—which were not subjected to such analysis when adopted—and major rules adopted more than ten years ago, since the pre-regulation estimates are no longer valid. Our 2003 draft report provided estimates of the costs and benefits of regulations in the aggregate, by program, and for major rules over the period October 1, 1992 to September 30, 2002. Each year in the future, OIRA plans to provide cost-benefit data for the preceding ten years.

Agencies do not generally submit estimates of costs and benefits of non-major rules nor do independent agencies submit such data to OMB. If this provision is intended to require executive branch agencies to produce cost-benefit information for non-major rules and independent agencies to begin to provide this information for all their rules, then OMB could not support such a requirement. Requiring benefits and costs of all rules and all paperwork to be quantified every year would be a massive, unjustified paperwork requirement. This could compel agencies to collect massive amounts of new information from regulated entities to support these new estimates, inadvertently creating one of the larger new paperwork burdens in recent history.

The fact that attempts to estimate the aggregate costs of regulations have been made in the past, such as the Crain and Hopkins estimate of \$843 billion mentioned in Finding 5, is not an indication that such estimates are appropriate or accurate enough for regulatory accounting. Although the Crain and Hopkins estimate is the best available for its purpose, it is a rough indicator of regulatory activity, best viewed as an overall measure of the magnitude of the overall impact of regulatory activity on the macro

economy. The estimate, which was produced in 2001 under contract for the Office of Advocacy of the Small Business Administration, is based on a previous estimate by Hopkins done in 1995, which itself was based on summary estimates done in 1991 and earlier, as far back as the 1970s. The underlying studies were mainly done by academics using a variety of techniques, some peer reviewed and some not. Most importantly, they were based on data collected ten, twenty, and even thirty years ago. Much has changed in those years and those estimates may no longer be sufficiently accurate or appropriate for an official accounting statement. Moreover, the cost estimates used in these aggregate estimates combine diverse types of regulations, including financial, communications, and environmental, some of which impose real costs and others that cause mainly transfers of income from one group to another. Information by agency and by program is spotty and benefit information is nonexistent. These estimates might not pass OMB's information quality guidelines. In particular, many of the studies they relied upon for these aggregate estimates are not sufficiently transparent about the data and methods to facilitate the reproducibility of the information by qualified third parties. That is why we have opted in the most recent Reports to Congress to report just the costs and benefits of major regulations prepared by agencies and reviewed by OMB over the last ten years.

Finally, even if the hundreds of agency analysts could generate the aggregate estimates of the costs and benefits of the over 113,000 final rules that have been issued since 1980, OIRA would be unable to read and evaluate them, given our current staffing level. Our concern about Section 6(a) would be greatly reduced if it were amended to say that agencies would provide the data "to the extent feasible," to reflect the instruction to OMB in Section 624(a)(1) of P.L. 106-554.

2. Should a Seven-Year Time Series Be Specified?

Section 6(b) would require that the accounting statement cover the same seven-year period covered by the Budget. We question the utility of providing this information over the seven-year budget cycle. All future costs and benefits must be presented and seven years is usually not a long enough time horizon. This points out a major difference as to how budgetary information is presented compared to benefit-cost information. Reducing the utility of benefit-cost information by forcing it into this budgetary framework is not the solution. OMB believes this provision would be improved if it were amended to say that OMB's preparation of the statement be done "consistent with the information-quality law" and "to the extent feasible." The cost-benefit information should be presented in annualized terms, with an indication of the appropriate time horizon.

3. Should the Accounting Statement Be "Part of the Budget?"

Section 6(c) would require the integration of OMB's accounting statement and report into the President's Budget. OMB believes that the accounting statement and report should continue to be transmitted "with" the President's Budget, not "as part of the budget" (as would be required by Section 6(c)). If the accounting statement and report

are to be submitted as part of the budget, such a change would significantly increase the workload burden of preparing the President's Budget documents without necessarily improving the quality of the report. Moreover, given that (1) OMB is currently required to provide for peer review and public comment on a *draft* accounting statement and (2) OMB does not believe it would be appropriate to submit a draft accounting statement and report with the President's Budget, OMB would have to submit cost-benefit data for the past fiscal year, not the fiscal year for which the President's Budget is submitted.

OMB believes it could be feasible to issue a separate volume with the budget that contains the final regulatory accounting report and perhaps some related budget information for comparison purposes. A separate volume might also permit adequate presentation of intangible costs and benefits. Intangible values such as fairness, ecology, privacy, and civil rights are not easily measured. These considerations might receive less attention than the reported quantitative information about costs and benefits, if the information is in summary form for a long list of programs packed in multiple budget documents.

4. Should We Undertake Pilot Tests of Regulatory Budgeting?

Section 6(d) contains the proposed pilot tests of regulatory budgeting. This is an innovative provision that, with proper refinement, could prove to be a helpful step forward in regulatory policy. We suggest the following refinements or clarifications. First, the pilot projects should be smaller, covering only NHTSA within DOT and the air office within EPA, because, in OMB's judgment, these are the only regulatory entities in the Federal government that are prepared—based on institutional and technical capacity—to tackle this ambitious project. As currently written, the agencies covered (Labor, Transportation and EPA) account for a large proportion of the total rulemaking activity of the Federal government. That is far too ambitious for a pilot effort. Moreover, OMB does not have adequate staffing to accomplish effective oversight of more than two modest pilots. Second, the provision should clarify that the alternative regulatory budget levels to be set by OMB (a) are for non-budgetary costs and (b) are hypothetical and informational in nature and thus do not have legally binding impact. The language should clarify that agencies are permitted to exceed the alternative "budget levels" if the agency head determines it is appropriate to do so or if statutory or other legal requirements for rulemaking compel the regulatory budget levels to be exceeded. Although we could be supportive of these pilot projects, we caution the Committee that overly ambitious language could lead to failure of these projects, which in turn might give the concept of "regulatory budgeting" a bad name. If the projects are successful, showing ways to achieve more health and safety protection at less overall cost, then the pilots may pave the way for more widespread use of regulatory budgeting throughout the Federal government. The project is so innovative that we believe it will be closely watched by other Federal agencies, State and local governments, and foreign governments interested in regulatory reform.

On regulatory budgeting, I would like to conclude with a few observations about why the Committee should be cautious about fostering direct comparisons between budgetary

outlays and non-budgetary, regulatory costs and benefits. First, unlike the fiscal budget, an audit to determine whether regulatory costs or benefits are accurate is not feasible. It is sometimes feasible to perform *ex post* evaluations of the costs and benefits of rules, and compare these *ex post* amounts to the pre-regulation estimates, but even these studies will typically provide only rough estimates. For this reason, regulatory costs and benefits are inherently more speculative than budgetary outlays. Second, some advocates of regulatory budgeting confuse the notion of accounting costs (e.g., audited budgetary expenditures) with social opportunity costs and hedonic costs, which are the foundation of regulatory costs. Social opportunity costs include consumer and producer surpluses as well as actual expenditures (price times quantity), and are therefore conceptually different from budgetary outlays or expenditures. Moreover, hedonic costs (e.g., the economic value of extra travel time, increased safety, and higher quality products) are measured and expressed in dollar units but they are not "expenditures" in a way that is directly comparable to budgetary expenditures. Third, while there is no such thing as an "intangible" or unquantifiable budgetary expenditure, some of the most important regulatory costs and benefits are intangible or very difficult to quantify (e.g., privacy, civil rights and some ecological amenities). Fourth, while the notion of regulatory "benefit" is well defined and often quantifiable, the budgetary process does not produce information on "benefits" for budgeted activities. Performance measurement in budgeting is on the rise but many performance measures are not economic in the same way that regulatory benefits are economic in nature. For these reasons and others, the Committee should be careful about suggesting that budgetary outlays and regulatory costs and benefits can be directly compared. Instead, regulatory cost-benefit information should be considered another piece of performance information that the budgetary process might consider. Valid benefit-cost information is an important consideration in budgeting for regulatory programs and this use of such information is certainly consistent with OMB's implementation of the Government Performance and Results Act (GPRA).

We also have concerns about two of the subsections that Section 6(d) would add to Chapter 11 of Title 31 of the U.S. Code. The new Subsection 1120(c) would require OMB to "include, as an alternative budget presentation in the budget submitted under section 1105 for fiscal year 2007, the regulatory budgets of the designated agencies for that fiscal year." The new Subsection 1120(d)(3) would require OMB to submit a report on the pilot projects to the President and to Congress that would "recommend whether legislation requiring regulatory budgets should be proposed and the general provisions of any legislation." Our view is that these provisions are inconsistent with the Recommendations Clause of the Constitution, which gives the President the authority to submit for the consideration of Congress such measures as the President judges necessary or appropriate. We therefore recommend that these two provisions be amended to require the submission of recommendations to Congress only "to the extent the President judges necessary or appropriate."

We are very pleased that the committee is interested in regulatory accounting and budgeting, and we believe that we can work with you to make significant advances in this area. Specifically, I would propose that the committee give strong consideration to the following three issues, which I believe are central to meeting the challenge of improving

the accounting and budgeting of regulatory costs and benefits. First, we must explore ways to measure those costs and benefits that are most difficult to quantify. Second, given the uncertainty of some agency estimates, agencies should be encouraged to base their cost-benefit analyses on valid scientific data and principles. Finally, I would urge the committee to consider the impact of more rigorous regulatory accounting and budgeting on the analytic resources in the agencies and OMB.

Requirement that OMB Devote Two Full-Time Staff to Tax Paperwork Reduction

Before discussing Section 3 of H.R. 2432, I would like to respond to Finding 1 in Section 2, which asserts that “OIRA's principal responsibility is to reduce the paperwork burden on the public that results from the collection of information by or for the Federal government.” When OIRA was created in 1980, it was accurate to say that OIRA's principal responsibility was paperwork review. However, OIRA has changed dramatically since 1980 as we have assumed additional responsibilities, such as regulatory review, information technology, information-quality oversight and statistical policy. During the same period, the number of full-time equivalent staff at OIRA declined steadily from a peak of 90 in 1980 to 47 in 2000, with a modest increase to 55 in 2003. Moreover, although reduction of paperwork burden is one of the primary objectives of the Paperwork Reduction Act of 1995 (PRA), another priority of the Act is to “ensure the greatest possible public benefit from and maximize the utility of” information collected by government in support of vital government functions. Both objectives of the PRA are important and they should not be considered in isolation of each other. Thus, we respectfully suggest that Finding 1 in Section 2 be revised to provide an up-to-date description of OIRA.

The requirement in Section 3 that OIRA devote at least two full-time staff to reducing tax-related paperwork burden is based on this finding in Section 2. It is also based on a perception that, since approximately 80 percent of overall paperwork burden by Federal agencies is imposed by the Internal Revenue Service (IRS), OIRA should have a substantial staff investment in review of IRS paperwork. While the 80 percent figure is roughly accurate, we believe this figure does not necessarily justify an increase in OIRA staff investment in IRS paperwork reviews. There are good reasons why OIRA does not make substantial staff investments in IRS paperwork review:

1. OIRA's staffing allocations reflect both the full range of OIRA's agency oversight responsibilities and OMB's historical deference to Treasury on tax policy and regulatory matters.
2. Most of the IRS paperwork burden is rooted in the Tax Code, and therefore beyond IRS' discretion to control.
3. There have been continued successes in the IRS-initiated efforts to reduce unnecessary paperwork burdens and IRS has perhaps the largest and most proficient paperwork-review office in the Federal government. Thus IRS has seldom been found to be in violation of the PRA.

4. Where OIRA has been effective in assisting IRS is in improved measurement of paperwork burden, an important analytical step toward performance measurement under the PRA and the GPRA.

I would like to elaborate on each of these four points.

1. Rationale for OIRA's Staffing Allocation to IRS

With our limited number of personnel (55 FTEs), OIRA must make staffing allocations that cover all agencies of the Federal government in five functional areas: regulatory review, paperwork review, information technology, information quality and statistical policy. Two of OIRA's four branches, comprised of 22 full-time analysts, are primarily responsible for the regulatory and paperwork reviews of all Federal agencies—including HHS, Labor, EPA, Transportation, Interior, Agriculture, as well as the new Department of Homeland Security and Treasury. The President expects thorough OMB oversight of *all* of these agencies, so these 22 full-time analysts are spread across dozens of large and small Federal agencies. In addition, these analysts devote their time to many other activities, including the annual development of the report to Congress on the costs and benefits of regulation, the report to Congress on the Unfunded Mandates Reform Act, and the Information Collection Budget.

Since some studies indicate that regulation is vastly more costly to the public than paperwork requirements per se—and a significant amount of paperwork not imposed by legislation is imposed by regulation—the allocation of these 22 full-time analysts is weighted toward regulatory review. (Keep in mind that good regulatory review also reduces paperwork burden, an activity that we undertake in close collaboration with the Advocacy Office of the Small Business Administration.) Congress recognized the importance of Federal regulation in the Regulatory Right to Know Act, which is the foundation of OIRA's annual report to Congress on the costs and benefits of Federal regulation. In the President's March 2002 call for public nominations of reforms to rules, guidance documents and paperwork, the vast majority of public interest—including small business interest—was in reform of rules and guidance documents. When paperwork burdens were nominated for scrutiny, they tended to be paperwork burdens created by regulation.

When I assumed the leadership of OIRA two years ago, there was one “desk officer” devoted to IRS. I understand that this staffing level for IRS paperwork has remained relatively constant since the Paperwork Reduction Act was first enacted in 1980. During the last year, in response to congressional interest, we increased senior-level support to that desk officer to better determine whether more OIRA staffing could produce less paperwork burden on small businesses and the general public. I must say that I have not been convinced that an increase in the number of IRS desk officers at OMB is a cost-effective use of scarce OIRA resources.

First, IRS and OMB have acquired over 20 years of experience under the PRA. Many of the more burdensome IRS information collections (e.g., high-volume tax forms

that are based on statutory requirements) have been reviewed by IRS and OMB on a recurring basis and the issues concerning them have been resolved in previous reviews. When Congress changes the Tax Code, the paperwork burdens change but in most cases the discretion at IRS and OIRA to influence that burden is limited.

Second, there has been a historical agreement between OMB and Treasury that provides Treasury a high degree of autonomy on tax and revenue regulatory matters. Under every President since Jimmy Carter, OMB has not, as a routine matter, reviewed IRS interpretive regulations. After President Reagan issued EO 12291 in February 1981, Treasury and OMB entered into a “Memorandum of Agreement” that exempted from OIRA review all IRS interpretive regulations. After President Clinton issued EO 12866 on September 30, 1993, the OIRA Administrator informed Treasury that “simply stated, we are continuing the Treasury Department’s current exemptions from regulatory review...” This Administration considered early on whether to change this relationship and a decision was made—above my pay grade and for good reasons—to retain the historical OMB-Treasury relationship.

It is important to understand the historical rationale for OMB deference to Treasury. First, OMB’s predecessor, the Bureau of the Budget, was once part of Treasury. When President Roosevelt moved the Bureau out of Treasury in 1939 and placed it in the Executive Office of the President, the staff expertise on tax policy and paperwork review remained with Treasury, where it continues to vastly exceed that of OMB. Considering specialization of labor, OMB staff investment in tax expertise is not very sensible. Second, the Watergate years taught us the dangers of politicizing the process of tax administration. By deferring to Treasury, each Administration since Jimmy Carter’s has insulated itself from the charge that it was using White House review of the IRS for political purposes.

Taking all of this into consideration, I believe that any rational OIRA Administrator would not be inclined to make review of IRS paperwork a more significant staffing priority. An understanding of how Congress creates paperwork burden through the Tax Code further underscores this conclusion.

2. The Tax Code and IRS Burden

In evaluating IRS’s record on burden reduction, it is important to note the challenge IRS faces in administering the Tax Code. To a greater extent than for other agencies and programs, IRS paperwork burden is driven by a statute (the Tax Code), and in particular the complexities of the Code. To ensure taxpayer compliance with our tax laws, IRS must collect a tremendous amount of information. This task is complicated by a massive, complex Tax Code that is subject to continuous revision. In the 15 years following the 1986 overhaul of the Code, Congress passed 84 tax laws. These laws required IRS to create and/or revise reporting and recordkeeping requirements, which in turn increased taxpayer burden. The Internal Revenue Service also had to make several changes to the 1040 schedules to implement the Economic Growth and Tax Relief Reconciliation Act of 2001. These statutorily driven revisions increased the burden on

taxpayers by 47 million hours. Moreover, there are other factors totally outside the control of IRS—most notably increases in the number of tax filings due to economic and population growth over the years—that increase the aggregate IRS burden hours but not—and this is important—the average burden on individual taxpayers.

Sometimes it is mandated *reductions* in tax liability that result in more paperwork burden. Consider, for example, the recently enacted tax benefit that allows teachers to subtract up to \$250 from their taxable income for the purchase of classroom supplies. To implement this tax benefit, the IRS had to provide significant explanation on the Form 1040 about eligibility requirements to claim the tax benefit. Eligible taxpayers must fill out a separate worksheet to compute the amount, up to \$250, that they may claim. This burden is necessary for IRS to determine if a taxpayer is claiming the benefit correctly. We reviewed IRS' work and did not find any unnecessary burden.

While we must ensure that paperwork burden is not unnecessarily increased in order to implement tax changes, it remains the case that taxpayers probably consider it a good trade-off to incur some additional paperwork burden in return for their taxes going down. OMB is committed to continued efforts to reduce paperwork burden responsibly—form by form, regulatory requirement by regulatory requirement. However, setting arbitrary staffing goals that have no analytic basis does not make sense.

3. Recent Efforts to Reduce IRS Paperwork Burden

Despite the challenges it faces in administering the Tax Code, IRS is making progress. As we reported in the recently released Information Collection Budget, in FY 2002 the Treasury Department achieved a net program change reduction due to agency actions of 9.51 million hours, largely as a result of actions within the control of IRS (i.e., changes in paperwork not due to new statutory requirements or violations of the PRA). After years of reporting increases, we are encouraged by this result and fully intend to build on this important accomplishment by achieving further reductions in the future. Several notable examples of such IRS actions include:

- Revisions made to Form 6251 – This form is used to implement the requirements of the Alternative Minimum Tax for individuals. IRS eliminated several lines and made other simplifying changes that resulted in a change in taxpayer burden of 5.5 million hours.
- Changes to Form 1040-EZ – This form is used by individuals who are single or joint filers with no dependents. IRS reduced taxpayer burden by 4.3 million hours by deleting several worksheets and a number of lines to this form.
- Changes made to Schedule D of Form 1040 – This form is used by individual taxpayers to report taxable income and calculate their correct tax liability. It was revised and simplified to make it easier for taxpayers to compute their capital gains and losses, resulting in a reduction of 2.9 million burden hours.

Treasury and IRS do a much better job than most agencies of carrying out their responsibilities under the Paperwork Reduction Act. IRS does not commit PRA violations and it has initiatives for reviewing its collections to identify opportunities for burden reduction. Few other agencies can say the same with equal strength. Because Treasury and IRS dedicate significant resources to paperwork review, and can demonstrate accomplishments in this area, OIRA does not have to dedicate additional resources to reviewing IRS paperwork to ensure that a careful PRA review is conducted.

4. Measuring IRS Burden

In recognizing that the Tax Code hinders IRS's ability to reduce taxpayer reporting burden, OMB has worked with IRS and Treasury to replace its current burden estimation methodology with a new measure of compliance burden. This revised measure will provide policymakers with a tool to assess the effects of legislative proposals to create and revise statutory provisions on the taxpayer burden *before* they are enacted. The specific goals of the new methodology include:

- measuring compliance burden more comprehensively and accurately by, for example, accounting for electronic filing methods;
- providing a tool to reduce compliance burden during the development and analysis of legislative and administrative proposals; and
- providing a tool to explain current levels of taxpayer burdens and the changes in those burdens due to administrative or statutory changes.

We believe that the capability of the new model to predict changes in burden due to changes in tax law—as well as changes in IRS tax administration—will allow OMB, Treasury, IRS, and Congress to work together to achieve tax policy objectives in a manner that minimizes taxpayer burden, consistent with the effective and fair collection of needed tax revenue.

In summary, OIRA has decided that its overall performance would not improve if OIRA reassigned its staff from other responsibilities to reviewing IRS paperwork. Admittedly, this is a judgment call. However, this is a judgment call that I as a manager must make in deciding how OIRA can best serve the President and carry out our numerous statutory responsibilities. The bottom line is that OIRA needs the “freedom to manage” and the mandated staffing in Section 3 represents an unprecedented and unwarranted intrusion on the ability of the President to manage his office.

In conclusion, the Administration recommends against enactment of this bill in its current form, but we would be prepared to work with you to fashion paperwork and regulatory improvement legislation that we could all support. That concludes my prepared testimony. If you have any questions, I would be happy to answer them.